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In the Supreme Court of the United States

OCTOBER TERM, 1924

MARGARET C. LYNCH, EXECUTRIX OF THE LAST WILL AND TESTAMENT OF E. J. LYNCH, DECEASED, ETC., PETITIONER
v.
ALWORTH-STEPHENS COMPANY
No. 273

ON CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR PETITIONER

STATEMENT OF THE CASE

On March 9, 1920, the Alworth-Stephens Company, a corporation, instituted suit by filing a complaint in the District Court of the United States for the District of Minnesota against E. J. Lynch as Collector of Internal Revenue for the District of Minnesota to recover the sum of $21,045.91 income and excess profits taxes paid for the year 1917.

On August 25, 1920, E. J. Lynch, as Collector of Internal Revenue for the aforesaid district, filed his answer. The case was tried by the Court without

a jury, and judgment was rendered for respondent for the sum of $20,322.89, with costs. (*Alworth-Stephens Co.* v. *Lynch*, 278 Fed. 959.)

Upon writ of error the Circuit Court of Appeals for the Eighth Circuit affirmed the judgment of the District Court. (294 Fed. 190.)

THE FACTS

In the year 1907 Henry Stephens and Albert L. Stephens, and their wives, by an option contract gave Marshal H. Alworth, of Duluth, Minnesota, for a period of ten years the exclusive right to explore for iron ore on 8,000 acres of land located on the Mesaba Range in the State of Minnesota, with the right to demand from them (they being fee owners) leases upon tracts of land to be thereafter selected from the land covered by the option contract.

The respondent was incorporated under the laws of the State of Minnesota in September, 1907, with an authorized capital of $100,000.00. Up to and including the year 1917 there had been issued, and was outstanding only $25,000.00 of its capital stock. Immediately after its organization it became the assignee from Mr. Alworth of the contract heretofore referred to and began exploring for ore. On August 25, 1908, the respondent having discovered ore, demanded and received from the fee owners, as provided in said option contract, a lease for fifty years on what subsequently became known as the Perkins and Silverton mines. This lease provided that the fee owners were to receive thirty cents per ton royalty on all iron ore mined,

with a guaranteed payment based upon fifty thousand tons per year, which was considered and designated as "ground rent."

The respondent on September 1, 1908, subleased these lands to John S. Lutes on an agreement of lease providing for a royalty of seventy-five cents per ton, an increase of forty-five cents per ton above that provided in the original lease, and as a further consideration the payment of $17,868.50 as a bonus. This lease was subsequently assigned by Mr. Lutes to the Perkins Mining Company, which thereafter operated the property until this ore was exhausted in September, 1919.

On July 1, 1908, the respondent, by an option contract, gave H. G. Dalton the right to explore for iron ore and take mining leases upon certain other tracts of land covered by the original option to the defendant in error. This option was thereafter assigned by Mr. Dalton to the Syracuse Mining Company, which, after exploring, discovered a body of ore, which became known as the "Hudson" mine. The respondent then demanded and received from the fee owners a lease, of the same terms and conditions as heretofore given, on this "Hudson" property, which was executed March 12, 1909. Thereupon the respondent executed to the Syracuse Mining Company a sublease on said Hudson property. The royalty provided in this sublease to be paid to the respondent was sixty cents per ton, being thirty cents above that provided in the original lease

to the respondent. The terms of the leases and subleases are practically identical. They provide in substance that the lessors "do hereby let, lease and demise unto the lessees * * * for a term of * * * years the property hereinafter described, * * * for the purpose of exploring for, mining, taking out and removing therefrom the merchantable iron ore * * *." They have the usual covenants allowing the lessees at any time upon giving notice to terminate the leases in so far as they are required to mine ore or pay royalties therefor. In consideration of the lessors' covenants, the lessees agreed to "on or before the tenth day of January, April, July, and October in each calendar year covered by this lease, or for the period of time for which this contract and lease continue in force, pay to the lessors for all iron ore which shall be mined and removed from said lands during the three calendar months next preceding the first day of the month in which payment is to be made as aforesaid, a royalty of * * * cents per ton for all iron ore so taken out, mined and carried away from said lands and premises * * *" and the lessees further agree that they "will mine and remove from said lands * * * at least fifty thousand tons annually * * *" or that they "will pay to the lessors an advance royalty which shall be treated and considered as ground rent of * * * cents per ton on said minimum quantity each year, the same as if actually mined and removed." The

leases and subleases also contain the usual covenants for forfeiture in the event the covenants are not performed on the part of the lessees.

Respondent's entire income for 1917 was derived from the rents and royalties received from these two subleases, i. e., from the subleases on the Perkins and Hudson mines.

For the year 1917 the respondent filed an income-tax return under Section 10 of the Revenue Act of 1916 showing a taxable net income of $77,605.98 and excess-profits tax return under Section 209 of the Revenue Act of 1917 based upon 8 per cent of its net income, less a deduction of $3,000.

On June 10, 1918, the respondent paid a total tax of $10,253.21, of which $4,292.74 was paid as income tax and $3,960.47 was paid as excess-profits tax.

The excess-profits tax return showed on its face that the respondent had a paid-in capital at the close of the year 1916 of $25,000. On a reaudit of the return by the Commissioner of Internal Revenue the respondent was assessed an additional excess-profits tax under Section 210 of the Revenue Act of 1917 in the sum of $17,128.44.

The respondent paid this additional tax and thereafter in April, 1919, filed a claim for refund for the sum of $25,737.58, claiming that its invested capital as of January 1, 1917, was at least $124,444.88 instead of $25,000, as shown by the original return. This claim for refund was rejected by the Commissioner of Internal Revenue and the respondent held to be

properly assessable under Section 210 of the Revenue Act of 1917. Thereafter, and on March 9, 1920, the respondent instituted the present action to recover back the sum of $21,045.91 based upon a restatement and recomputation of its tax liability in which it claimed to be entitled under the income-tax act to a deduction for depletion of its ore properties as representing a return of capital assets and for the purpose of the excess-profits act to be classified as a corporation having no invested capital or not more than a nominal capital.

The District Court in its findings of fact found that the respondent had an invested capital on January 1, 1917, of the sum of $25,000.00, and held that such an amount was not a nominal capital and that the respondent was taxable under Section 201 of the Revenue Act of 1917. The Court also held under the provisions of Section 12 (a) of the Revenue Act of 1916 that the respondent was entitled to deduct from its total net royalties received during 1917 the market value on March 1, 1913 (which it found to be 71.9% of the total net receipts) of the respondent's property interest in the ore in the mines which was extracted during 1917. The decision of the District Court was affirmed by the Circuit Court of Appeals.

THE STATUTES

Revenue Act of 1916 (Act of September 8, 1916, 39 Stat. 756, 765–770):

> SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total

net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how erected or organized, but not including partnerships, a tax of two per centum upon such income; * * *

SEC. 12 (a). In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting the gross amount of its income received within the year from all sources—

First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties; * * *

Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; (a) in the case of oil and gas wells a reasonable allowance for actual reduction in flow and production to be ascertained not by the flush flow, but by the settled production or regular flow; (b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, such reasonable allowance to be made in the case of both (a) and (b) under rules and regulations to

be prescribed by the Secretary of the Treasury. Provided, that when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in the case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date, no further allowance shall be made; * * *

Third. The amount of interest paid within the year; * * *

Fourth. Taxes paid within the year * * *.

Revenue Act of 1917 (Act of October 3, 1917, 40 Stat. 300, 301–307):

SEC. 201. That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income (here follow the percentages) * * *."

SEC. 203. That for the purpose of this title the deduction shall be as follows, except as otherwise in this title provided—

(a) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the pre-war period was of the invested capital for the pre-war period (but not less than seven or more than nine per centum of the invested capital for the taxable year), and (2) $3,000.

NOTE.—Section 4 of the Revenue Act of 1917 imposed a tax of 4 per cent in addition to that levied by Section 10 of the Revenue Act of 1916.

Revenue Act of 1918 (Act of February 24, 1919, 40 Stat. 1057, 1078–1079):

> SEC. 234 (a) That in computing the net income of a corporation subject to the tax imposed by Section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost, including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property at the date of the discovery, or within thirty days thereafter; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee.

ISSUE

Is the respondent, who is a lessee of mining properties, entitled to deduct, as depletion, under the provisions of the revenue act of 1916, any value of the ore belonging to the fee owner of the mine, which was mined and removed during the year 1917?

ARGUMENT

The respondent, in computing its net taxable income for the year 1917, is not entitled to deduct, as depletion, any value of the ore, belonging to the fee owner of the mine, which was mined and removed during the year 1917.

This is a test case involving a construction of Section 12 of the Revenue Act of 1916, granting, in the case of mines, "a reasonable allowance for depletion" as a deduction from gross income. The particular question is whether this allowance can be claimed by a lessee of mining property under the provisions of the Act.

The Circuit Court of Appeals for the Sixth Circuit has held that a lessee is not entitled to the allowance. (*Weiss, Collector,* v. *Mohawk Mining Company,* 264 Fed. 502. Petition for certiorari denied, 254 U. S. 637.) In the case at bar the Circuit Court of Appeals for the Eighth Circuit refused to follow the rule laid down in the Mohawk Mining Company case. Thousands of income tax returns of mining companies have been audited and taxes collected on the basis of the decision in the *Mohawk Mining Company case.* If the decision of the Circuit Court of

Appeals for the Eighth Circuit in the case at bar is correct, approximately thirty millions of taxes collected must be refunded. A correct construction of the Statute is therefore fundamental and of the utmost importance.

(a) The leases were not conveyances to the defendant in error of the ore in place

The Supreme Court has repeatedly had before it Minnesota leases of iron properties and has repeatedly held that they are only contracts of rental which carry the right to use, occupy and mine the ore, but are not conveyances of the ore in place. The force of these rulings goes to the fact that the ore in the ground at all times remains the property of the fee owner and as extracted the property of the fee owner is depleted.

Replying upon the cases of *Stratton's Independence* v. *Howbert*, 231 U. S. 599, and *Stanton* v. *Baltie Mining Co.*, 240 U. S. 103, the Supreme Court in the case of *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503, held that the Minnesota mining leases involved were not a sale of property and the monies paid by the lessees were not converted capital but rents or royalties, taxable as income under the provisions of the Corporation Excise Tax Act of 1909. The court says:

> All of the mining leases, hereinafter mentioned, with the exception of a contract with the Van Buren Mining Company, were executed before the organization of the corporations. Each of these instruments provided

that the owners of the property demised to the lessees, exclusively, all the land covered by the descriptions for the purpose of exploring for, mining and removing the merchantable iron ore which might be found therein for and during the period named, usually fifty years. The lessees were given exclusive right to occupy and control the demised premises and to erect all necessary buildings, structures and improvements thereon. Right was reserved to the lessors to enter for the purpose of measuring the amount of ore mined and removed and making observations of the operations in the mines. The lessees agreed to pay in most cases, twenty-five cents per ton for all ore mined and removed and, to make such payments monthly for ore mined and shipped during the preceding month. The lessees agreed to mine and ship a specified quantity of ore in each year, and, in default of this, to pay the lessors for the minimum amount specified, and take credit therefor and apply such sums upon ore mined and shipped thereafter in excess of such minimum. The lessees were to pay the taxes and to keep the property free from encumbrances and liens. Right was reserved to terminate the contract upon the failure of the lessees to comply with the terms thereof.

The form of the leases is shown in Exhibits 15 and 16, which were not in the printed record, owing to their length, but copies of which, pursuant to stipulation, have been sent to this court. An examination of Exhibit 16 shows that the lessees had the right to ter-

> minate and surrender the lease by giving the lessors, or those having their estate in the premises, sixty days' written action, and executing sufficient conveyance releasing all interest and right of the lesses in the premises with any improvements thereon, and surrendering the same in order and condition, etc., and that thereupon all liability of the lessees to taxes subsequently assessed on the demised premises or for rent thereof thereafter to accrue, or royalty in ores therefrom except on account of ores removed, should cease and determine; the lessees to be liable for all ores removed from the premises not theretofore paid for, and to pay for the premises rent or royalty for the year in which termination should be made, or the portion thereof which have expired, at the rate of $12,500 per annum.

In reviewing the Minnesota cases and adopting the construction of the State court that mining leases are not sales of ore in place, the opinion continues:

> These lands are situated in Minnesota, and this character of lease has long been familiar in that State, as a means of securing the development and operation of mining properties. Some years before the passage of the Corporation Tax Act, the Supreme Court of Minnesota had dealt with the character of such instruments. In the case of *State* v. *Evans*, 99 Minnesota, 220, that court, after a review of the English and American cases, said (p. 227):
>
> "The propriety of a lease for the purpose of developing and working mines is recognized by all of the cases, and the rule established by

> the great weight of authority that such leases do not constitute a sale of any part of the land, and, further, that iron or other materials derived from the usual operation of open mines or quarries, constitute the rents and profits of the land, and belong to the tenant for life or years, and to the mortgagor after sale on foreclosure, and before the expiration of the time for redemption. The rule, however, has no application to unopened mines in the absence of a contract, express or implied, for opening and leasing them." The same doctrine was held in *Boeing* v. *Oweley*, 122 Minnesota, 190, and in the last case of *State* v. *Royal Mineral Association*, 135 Minnesota, 332, in which the decision of the Circuit Court of Appeals in this case, that such leases were merely conveyances of the ore in place, was brought to the attention of the court, and that conclusion expressly denied, the Supreme Court of Minnesota saying:
>
> "We adhere to the doctrine of the *Evans and Boeing cases*, and hold these instruments leases. * * *"

Relying on the *Sargent Land Company case, supra*, the Supreme Court in *United States* v. *Biwabik Mining Co.*, 247 U. S. 116, again held that a Minnesota mining lease was not a conveyance of ore in place although the ore body could be measured with substantial accuracy. The Circuit Court of Appeals had held that the lessee was as much entitled as the fee owner to treat the value of his interest in the ore in the ground at the beginning of the tax period as

his capital and that such a lease was in every substantial way pro tanto a purchase. In reversing the Circuit Court, the Supreme Court said:

> This view of the character of these instruments and their legal effect differs from that taken by this court in the *Sargent Land Co. case*, 242 U. S. 503, wherein precisely similar iron ore leases were under consideration. In that case this court reached the conclusion that such leases were not conveyances of the ore in place, but were grants of the privilege of entering upon, discovering, and developing and removing the minerals from the land, and that the lessor's income from such operations was obtained by a corporation shown to be carrying on business, and upon principles laid down in previous cases in this court (*Stratton's Independence* v. *Howbert, supra; Stanton* v. *Baltic Mining Co.*, 240 U. S. 103), that such income was subject to taxation under the Corporation Tax Act of 1909.
>
> In the *Sargent Land Co. case* it was pointed out that the courts of Minnesota, certainly familiar with the physical characteristics of the ore deposits involved, had in a series of cases held these instruments to be leases, and that the royalties agreed to be paid were rentals in compensation for the privileges granted the lessee. We hold the conclusion of the Minnesota courts to be warranted by reason and authority (242 U. S. 503, and cases cited in margin, p. 518).

The Circuit Court in its opinion had distinguished the Sargent Land Co. case but in disapproving the attempted distinction the Supreme Court said:

> * * * The lessee takes from the property the ore mined, paying for the privilege so much per ton for each ton removed. He had this right or privilege under the form of lease here involved so long as he sees fit to hold the same without exercising the privilege of cancellation therein contained. He is, as we held in the *Sargent Land Co. case*, in no legal sense a purchaser of ore in place.

See also: *Chemung Iron Co.* v. *Lynch, Collector*, 269 Fed. 368.

It is settled by the above decisions that mining leases in Minnesota are not sales of ore in place and that lessees are not entitled to a deduction for depletion under the provisions of Section 12 (a) of the Revenue Act of 1916. The question of value as of March 1, 1913, of the ore in place therefore becomes immaterial so far as a lessee is concerned. The net income of the respondent was therefore properly stated in its original income tax return as $77,506.98, and the assessment of the tax upon that amount, which did not include a deduction for depletion, was correct.

(b) A lessee of a mine is not allowed any deduction for the depletion of the ore body under the provisions of the Revenue Act of 1916

It is the position of the petitioner that the depletion allowance under Section 12 (b) applies only to the physical exhaustion of the ore deposit. Part

second of Section 12 allows the taxpayer to deduct from his gross receipts certain losses "including a reasonable allowance for the exhaustion, wear, and tear of property arising out of its use or employment in the business or trade." This section is then subdivided into (a) and (b), and (b) provides "in the case of mines a reasonable allowance for depletion. * * *"

Webster defines the word "depletion"—"to empty or unload, as the vessels of the human system, by blood letting or by medicine." This definition clearly shows that depletion means the emptying of something physical. The word depletion is derived from the Latin word "deplere," which means "to empty out," and the word "deplere" is made up from the Latin word "plere," meaning "to fill" and when joined with "de" meaning the opposite; the verb deplere means "to unfill," "to empty."

The respondent is not a fee owner but a lessee. All it has under its lease is contractual right and these rights become exhausted, or more properly speaking, are exercised, when the contract is completed.

If Congress had intended that this section should apply to the exhaustion of a contractual right it would not have used the word "deplete." The word deplete is not used to express the idea that contractual rights are being exercised. The word depletion is used only "in the case of mines" and it is certain Congress used it in its ordinary sense; that is, the emptying of the ore deposits.

As was said by this court in the *Sargent Land Company case*, 242 U. S. 503, 524, in referring to what was meant by the word "depreciation":

> We think Congress used the expression in its ordinary and usual sense as understood by business men.

In *New Creek Company* v. *Lederer*, 295 Fed. 433, 437, the Circuit Court of Appeals for the Sixth Circuit said on this question:

> On the theory of the statute, as we read it, depletion allowance was intended as a return to the taxpayer of the original cost of the coal.

In that case certiorari was refused by this court. (*New Creek Co.* v. *Lederer*, 265 U. S. 581.)

The proviso in the same paragraph clearly indicates that the purchaser of the mineral deposits is the only one considered in the case of mines, and in the case of oil and gas wells. The proviso reads as follows:

> That when the allowance authorized in (a) and (b) shall equal the capital originally invested, or in case of purchase made prior to March 1st, 1913, the fair market value as of that date, no further allowance shall be made.

This proviso defines the limitation of the allowance—in ordinary cases to the capital originally invested, and "in case of purchase made prior to March first, nineteen hundred and thirteen, the fair market value as of that date." And these both are the cost or value of the property which is consumed or depleted.

In the case at bar, the corporation respondent made its leases before 1913, so it must come under the second clause.

But it can not come under the clause "in case of purchase" for that does not include a lease. It can refer only to the purchase of property. When one leases property he does not "purchase" it. The word purchase applies only to the ownership of property.

The word "purchase" as used in the proviso, plainly indicates that Congress had in mind only the purchaser of the ore deposit. The lessee did not purchase the ore deposit and the respondent does not contend that it is the purchaser in the present case. It was decided in *The Sargent Land Company case* and other cases cited, *supra,* that a lease of an ore property is not a sale of the ore deposit. The lessee did not purchase anything previous to March 1st, 1913. It merely made an agreement to mine ore and certainly did not purchase any property which could be exhausted by wear and tear or by its use or employment in the business. The lessee does not sustain a loss by mining, as does the owner. The owner loses his ore by mining, but the lessee loses all his rights under the lease by not mining. So far as depletion alone is concerned, the owner loses nothing if the ore is not mined. The rights of a lessee under a lease are not subject to physical exhaustion, wear and tear. The rights of the lessee are not employed or used in mining the ore. The lessee uses up and depletes the

physical property (the ore) of the owner in the busi
ness of mining. The lessee in the present case i
claiming a depletion allowance because of the deple
tion of the ore deposit not its own, but that of another
the owner. Congress did not intend that one party, a
lessee, should be allowed depletion for using up anothe
party's property in a business. Instead of the lesse
sustaining a loss by doing the business of mining, h
brings all his rights under the lease to fruition.

The respondent in this case acted under it
lease and instead of any loss to it there was a
gain. The rights of a lessee under a lease are no
part of the physical equipment of a mine, so as t
bring them under exhaustion, wear and tear, o
depletion from their use in the business of mining
The lessee has neither more nor less ore by workin
the lease. The owner is in an entirely different posi
tion. If the ore is not mined, he has it. If it i
mined, it is gone and he has no ore. It is the loss o
departure of this ore, not the right to dig it, fo
which the Act allows depletion. Thus, if the owne
of mines, either himself or through a lessee, doe
business of mining, there is to him an inevitable los
of his ore. And if the lessee does mining under hi
lease, there is no loss whatever of ore to him. Al
he has done is to exercise his rights to mine. Th
exercising of this right until the ore is exhausted i
not a thing for which depletion can be claimed. I
seems that the only question to determine in thi
case is what property is being depleted by bein

used or employed in the business of mining. In answer we submit that the only property used in the business of mining ore is the ore itself and the machinery used to mine it. And we also submit that the owner's ore has been used up, and the lessee's machinery has, to a certain extent, been used up; that for the ore used up the owner alone is allowed to take a deduction for "depletion," and that, so far as the machinery owned by the lessee is used up, he is allowed to take a deduction for "depreciation." The lease itself was not worn out or exhausted by the exercise of rights arising under it. The ore of the owner was depleted. The lease was still intact.

It is true that the rights of the lessee became less valuable each year, but this would be true of other parties. If, for example, the owner, instead of leasing the mine, were to contract with a party to mine all the ore for a fixed sum per ton, at which figure the contractor would have a profit, in such case the contractor would see that the final depletion of the mine would end his profit, but he would not be entitled to a deduction from his income profits because of the depletion of the mine.

Or, take another example, where the owner of the mine contracts for the hauling of the ore from the mine to the railroad and loading it. In such case if the contractor has a profitable contract, he realizes that each year's depletion of the mine cuts down the amount of profit he will be able to make in the future,

and when the mine is entirely depleted, the contract will have no more value. But it would not be contended that the contractor was entitled to a deduction from his income profits because of the depletion of the mine. This is not "depletion" but simply that the source of income has ceased.

But the contractors in these cases are in exactly the same position as the lessee, and if the lessee is entitled to such a deduction for depletion, the contractor in either example would be entitled to claim such a deduction for himself.

It is of course true that in many cases where the thing or right of contract is of great value to the owner there may be a lessening of value from year to year, without the owner being able to claim a deduction for it under some of the Internal Revenue Acts. These acts provide for a tax on all incomes, and then they provide for deductions in certain cases. And it is of course true that the deductions allowed by the respective revenue acts change, as experience shows is just or desirable. So where a corporation or an individual has a lease or contract such as were instanced hereinbefore, while the value of this may become less from year to year, the revenue act may not allow any deduction to the owner on that account.

Thus the Revenue Act of 1909 allowed for "depreciation" but nothing for "depletion" of mines. The Revenue Act of 1913 allowed for depletion of mines not to exceed 5% of the gross value of the output for the year. The Revenue Act of 1916 allowed for depletion of mines not to exceed the market value in

the mine of the output during the year, with the limitation given in the proviso quoted. And the Revenue Act of 1918 for the first time allowed depletion to a lessee by providing that the deduction for depletion of mines should be equitably apportioned between the lessor and lessee.

So the growth and development of the deduction is easily traced, and in no one of the cases is the change an interpretation of the previous existing law, but is a development, a change of the law itself.

And the question at issue in this case is the allowance for deduction for depletion under the provisions of the Revenue Act of 1916.

This Court referred to the depletion allowance under the Act of 1916, in the *Sargent Land case*, 242 U. S., 503, 525, in the following language:

> True, the value of the mine is lessened from the partial exhaustion of the property, and, owing to its peculiar character, can not be replaced. But in no accurate sense can such exhaustion of the body of the ore be deemed depreciation. It is equally true that there seems to be a hardship in taxing such receipts as income, without some deduction arising from the fact that the mining property is being continually reduced by the removal of the minerals. But such consideration will not justify this court in attributing to depreciation a sense which we do not believe Congress intended to give to it in the Act of 1909.
>
> It may be admitted that a fair argument arises from equitable considerations that, owing

> to the nature of mining property, an allowance in assessing taxes upon income should be made for the removal of the ore deposits from time to time. Congress recognized this fact in passing the Income Tax Section of the Tariff Act in 1913 (Section II, 38 Stat. 166, 167), when it permitted "a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year for which the computation is made"; and in the Income Tax Law of September 8, 1916 (39 Stat. 756, 769), a reasonable allowance is made in the case of mines for depletion thereof, "not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made." These provisions were not in the Act of 1909, and, as we have said, we think that Congress, in that Act, used the term "depreciation" in its ordinary and usual significance. We therefore reach the conclusion that no allowance can be made of the character contended for as an item of depreciation.

This Court has in this decision clearly indicated that the depletion allowance in the case of mines, under the Act of 1916, applies to the "exhaustion of the body of the ore." It states that "the mine is lessened from the partial exhaustion of the property and can not be replaced." The court states that "the mining property is being continually reduced

by the removal of the minerals." The court also stated that an allowance "should be made for the removal of the ore deposits." The court then goes on to say that "Congress recognized this fact," in the Act of 1913 and in the Act of 1916. In other words, this court has stated that Congress recognized the fact that an allowance should be made for the removal of the ore deposits, and we submit that under the Act of 1916, an allowance for the removal of the ore deposits was for the owner and the owner alone, of the physical property—the ore deposits. The Act of 1916 in the case of mines does not provide, no matter how broad an interpretation may be made, for the exhaustion of the contractual rights of a lessee under his lease. Congress did not provide, under this Act, that one party, the lessee, be given an allowance for the depletion of another's (the owner's) ore deposit.

The position of the Government in allowing depletion only to the fee owner has received the sanction of the courts and the identical question, now before this court, has been decided adversely to the defendant in error's contentions by the Circuit Court of Appeals for the Sixth Circuit, in *Weiss, Collector*, v. *Mohawk Mining Co.*, 264 Fed. 502. That case was the culmination, under the Revenue Act of 1916, of various attempts on the part of lessees and lessors of mining property to establish their right to depletion under the earlier revenue acts of 1909 and 1913.

All of the leases involved in the *Mohawk case*, as in the case at bar, are in the usual form of mining lease

generally used in Minnesota in connection with the leasing of iron ore lands. The provisions of the leases in no sense constitute a sale of ore in place, but provide merely for the payment of rents and royalties for the privilege of mining and removing the ore. These facts bring the case squarely within the rule announced in the *Mohawk Mining case*.

The Mohawk Mining Company was a Minnesota corporation. On March 1, 1913, it was lessee of certain iron mining property in Minnesota. By the terms of the lease it was to pay the fee owners a royalty of 25 cents per ton, was to pay a certain minimum each year, and was given a term amply long enough to permit extraction of all the ore on the premises. The amount of ore in place March 1, 1913, was known with substantial accuracy, and its value at that time in the ground was known to be substantially 50 cents per ton; in other words, 25 cents per ton in addition to the royalty which must be paid when it was taken out. The plaintiff's theory was that the net operation proceeds of such ton of ore thereafter mined should be carried, 25 cents to royalty account, 25 cents to the capital account as of March 1, 1913, and the balance to profit. Under the Act of September 8, 1916, the Mohawk Company claimed an allowance for depletion to the extent of 25 cents excess per ton, claiming that that represented the value of its interest on March 1, 1913, which had been consumed by the mining operations for the period covered by its tax return. The Court said:

The only question involved is whether the Mohawk Company, because it is only lessee, is not entitled to the allowance which it is conceded would be rightful if it were the fee owner. Counsel for the taxpayer urge several reasons why this depletion should be allowed to the lessee in some cases as it is in others to the fee owners, among which are that by the words of the statute, the allowance is made to the taxpayer rather than either to owner or to lessee; that it would be natural for Congress to intend such allowance to be made to the party which actually suffered the substantial depletion, and that this, in a case like the present, is the lessee; that the contrary theory necessitates the allowance of the depletion to the lessor in this and all cases of royalty losses, with the result that while the lessor's only interest in the property is the royalty, and while the royalty is taxable income, the lessor will have a depletion allowance which will wipe out the royalty and leave him with no tax to pay, and this is said to be an absurd result; and that, under the wording of the act and the regulations of the department (in particulars which we have not set out), if the Mohawk Company had bought this lease from a former lessee on the 2nd day of March, 1913, for the existing market price of ore in place, it could have had this allowance which it now claims (under the mere subterfuge of calling the purchase price "advance rental"), while the law plainly intends that the owner, on March 1st, and the purchaser

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on March 2d, of any particular interest shall be treated alike.

These contentions would deserve serious consideration if the questions involved were open; but we can not think that they are. We can not conceive any substantial distinction as applied to a mine between that depreciation or allowance for capital assets consumed which was sought by mine owners under the earlier acts and that depletion which was expressly allowed by the amendment of 1916. From every point of view this kind of depreciation or allowance was depletion, and this allowed depletion is depreciation or diminution of capital, and when the question of right to the allowance arises as between fee owner and lessee it can make no difference whether the claimed allowance is called by one name or by the other. In *U. S.* v. *Biwabik Co.*, 247 U. S. 116, 36 Sup. Ct. 462, 62 L. Ed. 1017 (arising under the act of 1909), it was ruled, after full consideration, that under a lease practically identical with the Mohawk lease now involved the nature of the interest held by the lessee was not such as to permit it to claim the allowance, but that the contingencies which attended the character of the lessee's interest barred it from claiming that its capital assets had been diminished. It is true that the question whether the mining of ore could be considered depreciation in any event was underlying, and that this question has been completely removed by the amendment of 1916; but the Supreme Court did not rest its conclusion at all upon the definition of depreciation.

We do not overlook counsel's argument that the question really involved in the *Mitchell and Biwabik cases* was whether the proceeds of a sale of capital assets should be eliminated from the receipts of the year before the gross income was stated and hence did not reach an allowance of a business loss during the year permitted to be deducted from the gross income, which character the depletion allowance is said to bear; but we think the provision regarding depletion, in real substance and effect, pertains to a consumption of capital assets rather than to a business loss. We also observe that, by virtue of the effect of the minimum royalty provisions in the Mohawk lease, it was, on March 1, 1913, under an affirmative obligation to remove—or at least to pay for—about two-thirds of the ore then in the ground and that this affirmative obligation probably covered all the ore mined during the taxing periods now involved. However, no controlling force has been put, in the former cases, upon the presence or absence of this affirmative obligation, and we are inclined to regard its extent as an incident of a particular case which cannot control the general rule.

Holding this view as to the equivalency, for this purpose, between "depreciation," "consumption of capital assets," and "depletion," and as to the effect which must be given to the decision in the *Biwabik case*, it follows that the judgment below must be reversed, and judgment entered for the defendant, and the case is remanded for that purpose.

On Petition for Rehearing (page 605):

Per Curiam: The application for rehearing points out that, in some of the cases cited in the opinion, allowance or credit for materials exhausted was sought or allowed on the ground that they represented, not income at all, but capital assets consumed, and that the opinion erroneously refers to some of these as if they all involved "depreciation." The correction of whatever inaccuracy there is in the opinion in this respect does not affect our conclusion. In the *Biwabik case*, the lessee was not heard to say that his capital assets had been consumed by his mining operations, and we interpret that decision as rooting in an essential degree on the idea that the nature of the lessee's title forbade him to make this claim. We can not read the decisions of the Supreme Court as having determined that the exhaustion of ore reserves is so inherently a business loss, rather than an impairment of capital, that a statutory grant of the right to deduct for depletion on that account will reach a case which has been adjudged not to involve the diminution of capital assets. We think the substantial principles established by the decisions are that both the royalty received by the fee owner and the sums received by the operating lessee above the cost of operation are income; that the statutory reduction for "depletion" can not be twice credited, once to the fee owner, and once to the lessee; and that the exemption belongs of right to the fee owner.

> The application for rehearing must be denied, but the opinion will be refiled, with corrections in the matter indicated. (*Weiss* v. *Mohawk Mining Co.*, 264 Fed. 502, 504, 505, 506.)

A petition for certiorari was then filed with the Supreme Court to review this decision, assigning the following reasons:

> 1. The construction of Section 12 of the Revenue Act of 1916 with respect to the depletion allowance has never been before this court, nor before any lower court except in the instant case.
>
> 2. The question involved is of great general importance affecting the liability for taxes of lessees of mineral property throughout the United States. When iron ore, copper, lead, zinc, oil, gas, and precious metals, are considered, lessees include many thousands of taxpayers and the taxes involved amount to a large sum of money.
>
> 3. *United States* v. *Biwabik Mining Company*, 247 U. S. 116, which the Circuit Court of Appeals regarded as decisive of this case, arose under the Excise Tax Act of 1909 while the case at bar arises under the Act of 1916. We believe the Circuit Court of Appeals misinterpreted the provisions of the 1916 Act, giving a reasonable allowance in cases of mines, and the purpose of Congress in granting such allowance, and misconceived the effect of the decision of this court in the *Biwabik case*. (Page 6, Petition for Certiorari in *Mohawk Mining Co.* v. *Weiss.*)

The petition was denied October 18, 1920, *Mohawk Mining Co.* v. *Weiss*, Collector, 254 U. S. 637.

(c) The provisions of the Revenue Act of 1918, which apportioned the deduction for depletion between the lessor and fee owner of mining property, are not a construction by Congress of the provisions of the Revenue Act of 1916, but a new law.

Respondent contended in the lower Court that the Revenue Act of 1918, which apportioned the deduction for depletion between the lessee and the fee owner of mining property (Sec. 234 (a) (9)) was an interpretation by Congress of the meaning to be given to the provisions of the Revenue Act of 1916. In this connection it is sufficient to say that the two acts are separate and distinct and that the Revenue Act of 1918 in express terms repeals the provisions of the Revenue Act of 1916.

In the report of the Revenue Act of 1916 of the managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate, the following appears:

> The House agreed to the Senate amendment that an amendment providing that the Secretary of the Treasury should have power to make rules and regulations with reference to the allowance allowed for the exhaustion of oil and gas wells and mines, and eliminating the provision with reference to timber as this portion of the amendment was not necessary in view of the fair market value of property on March 1, 1913, being agreed upon as the date for the basis for determining the amount

> of the gain derived from the sale or disposition of property. (Congressional Record, Vol. 53, Part 13, p. 14110.)

This shows that the allowance for the exhaustion (depletion) of mines in the Act of 1916 was considered to apply only to the owner of the *property*.

In the report of the Committee on Ways and Means in the Revenue Act of 1918, submitted September 3, 1918, by Mr. Kitchin, the following appears on page 10:

> The depletion provision of existing law does not grant an allowance for cost of development. In the case of mines, oil and gas wells, such an allowance seems only equitable and fair and the bill provides that a reasonable allowance in such cases be allowed for depreciation of improvements. *The bill also corrects an inequality of the present law* by providing for an equitable apportionment of the depletion allowance between lessor and lessee. [Italics ours.]

Respondent insists in fact that the Act of 1916 already provides for this apportionment which it claims for itself, for its claim for deduction apportions it between the lessor and the lessee.

But the report quoted shows that Congress understood that this provision of the Revenue Act of 1918 was not an interpretation of the 1916 Act but was an amendment, and this was an entirely new provision, to correct an inequality of the 1916 law.

That the contention of the respondent in this particular is without merit is shown by the decision

of this Court in the case of *United States* v. *Stanley Field, Executor of Kate Field*, 255 U. S. 257. With reference to that case, the Revenue Act of 1916 did not in express terms include property passing under a power of appointment as part of the gross estate of a decedent for the purpose of computing the estate tax. The Revenue Act of 1918, however, expressly included such property as part of the gross estate, and it was argued on behalf of the Government that the 1918 Act was interpretative of the proper construction to be given the provisions of the 1916 Act. This Court, in refusing to adopt this construction, said:

> It would have been easy for Congress to express a purpose to tax property passing under a general power of appointment exercised by a decedent had such a purpose existed; and none was expressed in the Act under consideration. In that of February 24, 1919, which took its place, the section providing how the value of the gross estate of the decedent shall be determined contains a clause precisely to the point (Sec. 402 (e), 40 Stat. 1097):
>
> "To the extent of any property passing under a general power of appointment exercised by the decedent (1) by will, or (2) by deed executed in contemplation of, or intended to take effect in possession or enjoyment at or after, his death, except," etc.
>
> Its insertion indicates that Congress at least was doubtful whether the previous Act included property passing by appointment. (See *Matter of Miller*, 110 N. Y. 216, 222; *Matter of Harbeck*, 161 N. Y. 211, 217–218;

United States v. *Bashew*, 50 Fed. 749, 764.) The Government contends that the amendment was made for the purpose of clarifying rather than extending the law as it stood, and cites a statement to that effect in the Report of the House Committee on Ways and Means (House Doc. No. 1267, p. 101, 65th Cong., 2d Sess.). It is evident, however, that this statement was based upon the interpretation of the Act of 1916 adopted by the Treasury Department. The same report proceeded to declare (p. 102) that "The absence of a provision, including property transferred by power of appointment, makes it possible, by resorting to the creation of such a power, to affect two transfers of an estate with the payment of only one tax"; and this, together with the fact that the committee proposed that the law be amended, shows that the Treasury construction was not treated as a safe reliance. (*United States* v. *Field*, 255 U. S. 257, 264.)

In the case of *Lynch* v. *Hornby*, 247 U. S. 339, it was argued that the Revenue Acts of 1916 and 1917 were declaratory of the meaning of the 1913 Act. In refusing to so hold this Court said:

> In the more recent Income Tax Acts, provisions have been inserted for the purpose of excluding from the effect of the tax any dividends declared out of earnings or profits that accrued prior to March 1, 1913. This originated with the Act of September 8, 1916, and has been continued in the Act of October 3, 1917. We are referred to the legislative history of the Act of 1916, which it is contended

> indicates that the new definition of the term "dividends" was intended to be declaratory of the meaning of the term as used in the 1913 Act. We can not accept this suggestion, deeming it more reasonable to regard the change as a concession to the equity of stockholders granted in the 1916 Act, in view of constitutional questions that had been raised in this case, in the companion case of *Lynch* v. *Turrish*, and perhaps in other cases * * * (pages 345–346).

And with reference to a like contention regarding the Revenue Acts of 1916 and 1918 as interpretative of the Acts of 1913, this Court said in the case of *Penn Mutual Life Insurance Co.* v. *Lederer, Collector*, 252 U. S. 523, at page 535:

> The Penn Mutual Company, seeking to draw support for its argument from legislation subsequent to the Revenue Act of 1913, points also to the fact that by the Revenue Act of September 8, 1913, c. 463, 39 Stat. 756, 768, Sec. 12, subsections second, subdivisions c, the rule for computing gross income there provided for mutual fire insurance companies was made applicable to mutual employers' liability, mutual workmen's compensation, and mutual casualty insurance companies. It asserts that thereby Congress has manifested a settled policy to treat the taxable income of mutual concerns as not including premium refunds; and that if mutual life insurance companies are not permitted to "exclude" them, these companies will be the only mutual concerns which are thus discrimi-

> nated against. * * * If such later legislation could be considered in construing the Act of 1913, the conclusion to be drawn from it would be clearly the opposite of that urged. * * *

And, again, on pages 537–538 the following:

> In support of the company's contention that the interpolation of the words "within the year" is necessary in order to support the construction given to the act by the Circuit Court of Appeals we are asked to consider the legislative history of the Revenue Act of 1918 (enacted February 24, 1919, c. 18, 40 Stat. 1037); and specifically to the fact that in the bill as introduced in and passed by the House, the corresponding section (233 (a)) contained the words "within the taxable year" and that these words were stricken out by the Conference Committee. (Report No. 1027, 65th Cong., 3d Sess.) The Legislative history of an act may, where the meaning of the words used is doubtful, be resorted to as an aid to construction. (*Casimetti* v. *United States*, 242 U. S. 470, 490.) But no aid could possibly be derived from the legislative history of another act passed nearly six years after the one in question. Further answer to the argument based on the legislative history of the later act would, therefore, be inappropriate.

It is apparent from the foregoing authorities that the provisions of the Revenue Act of 1918 have no connection whatever with the provisions of the Revenue Act of 1916. It is unfair to accuse Congress of doing a vain and useless thing, and certainly it would be vain and useless to enact into law the interpretation of an existing law.

If the claim of respondent is right in this case, then the Court must hold that the provision in the Revenue Act of 1918, Sec. 234 (9)—

> In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessees—

is useless and vain. The claim of respondent is that it was the law before Congress stated it, and when it enacted that provision in the law of 1918 it did a vain, useless, and unnecessary thing.

The necessity for enacting the provisions of the 1918 law regarding depletion allowance and its apportionment conclusively proves that the provisions of the 1916 law could not be interpreted in the manner contended for by the respondent.

In the decision of the Circuit Court of Appeals in this case, reference is made to the fact that the Treasury Department by Treasury Decision No. 3386, under date of August 22, 1922, held that a lessee of an oil or gas well was entitled to depletion under the Revenue Act of 1916. The Department made this ruling because it understood the decisions of this Court to hold that there was no ownership of oil or gas in place, under the ownership of the land, so

interpreting the cases of *Brown* v. *Spillman*, 155 U. S. 665; *Ohio Oil Co.*, v. *Indiana*, 177 U. S. 190; *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U. S. 61; *Oklahoma* v. *Kansas Natural Gas Co.*, 221 U. S. 229; *Walls* v. *Midland Carbon Co.*, 254 U. S. 300.

But this position of the Department is consistent with the denial of deduction for depletion of mines. For it holds in both cases that depletion should be allowed to the owner of the substance or product (whether oil, gas, or ore) of the mine, and this Court has expressly held that under these mining leases, the lessee does *not* own the ore, and the Department understood this Court to hold that in the case of oil and gas, the ownership of the surface did not give ownership of the oil and gas in place, but that it belonged to the lessee (or other party) who reduced it to possession. So that when the reasoning and reason of the Department's Treasury Decision No. 3386 is understood, it is seen that it is the only possible ruling which is consistent with the holding in this case of a mine.

We believe that in our argument we have shown the error of the Court of Appeals, the opinion of which is mainly to show that the *Mohawk case*, *supra* was incorrectly decided and that the *Biwabik case*, *supra*, does not apply in the case at bar.

CONCLUSION

It is submitted that the respondent, a lessee of mining property, is not entitled to the deduction for depletion allowed under the provisions of Section 12 of the Revenue Act of 1916, and therefore the judgment of the lower Court, in so far as it allowed this depletion, should be reversed.

Respectfully submitted.

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